Moody's Investors Service

Municipal Credit Research
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NEW ISSUE : California (State of)

MOODY'S RAISES STATE OF CALIFORNIA GO RATING FROM Aa3 TO Aa2. ($22 BILLION IN DEBT AFFECTED)

Ratings on Bonds Supported by State Leases Raised from A1 to Aa3 ($6 Billion In Debt Affected)

State
CA

Moody's Rating

ISSUE	**RATING**
General Obligation Bonds	Aa2

Sale Amount	$850,000,000
Expected Sale Date	09/13/00
Rating Description	General Obligation Bonds

Opinion

NEW YORK, Sep 7, 2000 – Moody's has raised the rating on the general obligation bonds of the State of California to Aa2 from Aa3, affecting $22 billion in debt, including $850 million in bonds to be issued on September 13, 2000. In addition, the ratings on bonds supported by state leases, issued through the California State Board of Public Works and several other state authorities, have been raised to Aa3 from A1, affecting an additional $6 billion in debt.

The upgrade reflects the strength and diversity of a state economy that continues to exceed consensus growth expectations and comfortably outpaces the nation in terms of personal income and employment growth. The increased diversity of the economy has positioned the state well for future expansion, and the deep customer base of the high technology sector decreases the likelihood of a statewide economic downturn absent a national recession. Consensus economic forecasts call for the state's economy to remain strong and to continue to outpace the nation. Consistent with its historical practice, the state's official economic forecast for the near term remains at or below these forecast estimates.

The economic growth over the last several years has dramatically improved the state's financial condition, driving cash and budget reserves to record levels. While the targeted budget reserve remains moderate at 2.2% of general fund revenues, other internal funds are available to provide a buffer against volatile revenue performance during periods of economic downturn. The state currently estimates that it will end the current fiscal year with internal borrowable resources totaling more than $12 billion, eliminating the need for a cash-flow borrowing for the first time in over two decades.

The upgrade also reflects the state's increased fiscal conservatism, particularly over the last two years. The state has realized a dramatic increase in revenue collections, due in large part to growth in capital gains tax collections. Overall revenues in fiscal 2000 came in approximately 13% over original budget estimates. Such strong results were driven by personal income tax revenues, which were 19% in excess of budget and 27% over prior year actuals. But despite a nearly $9 billion revenue windfall in the prior fiscal year, the state resisted efforts during the fiscal 2001 budget debate to spend the bulk of such unanticipated resources on recurring expenses. General fund expenditures for the current fiscal year are $11 billion higher than fiscal 2000 levels. However, this figure includes $2 billion in one-time tax relief and approximately $5 billion in one-time capital expenses that largely could be scaled back if revenue collections do not meet budget estimates. In addition, the state has again based its current year budget on conservative revenue estimates.

While the credit strengths described above provide the basis for our rating upgrade and stable outlook, the state credit remains tempered by its relatively inflexible budget structure, due in large part to education expenditures mandated by Proposition 98; its potentially volatile revenue structure during periods of economic weakening; the lack of a formal mid-year spending adjustment mechanism; and the negative impact a stock market correction could have on capital gains tax collections. In addition, the state's significant infrastructure needs put pressure on its moderate debt position, although developing debt management policies offer the potential for managing debt levels successfully.

The general obligation bonds to be sold on September 13th are being used to fund various state and local capital facilities projects, and to retire commercial paper notes issued to finance investments in public schools and higher educational facilities, and various clean air and transportation improvement projects.

Following is a listing of the various bonds affected by this rating action. Approximately $28.1 billion of such bonds is outstanding.

STATE OF CALIFORNIA GENERAL OBLIGATION BONDS

- Various issues upgraded from Aa3 to Aa2. Approximately $21 billion was outstanding as of July 1, 2000. This Aa2 is also assigned to the $850 million in bonds to be issued on September 13, 2000.

STATE PUBLIC WORKS BOARD LEASE REVENUE BONDS

- Various non-University of California Public Works Board issues upgraded from A1 to Aa3. Approximately $4.7 billion was outstanding as of July 1, 2000.

OTHER STATE BUILDING LEASE PURCHASE ISSUES

- Various issues upgraded from A1 to Aa3. Approximately $989 million was outstanding as of July 1, 2000.

EAST BAY BUILDING AUTHORITY CERTFICATES OF PARTICIPATION

- Upgraded from A1 to Aa3. Approximately $80 million was outstanding as of July 1, 2000.

SAN BERNADINO JOINT POWERS FINANCING AUTHORITY

- Upgraded from A1 to Aa3. Approximately $61 million was outstanding as of July 1, 2000.

SAN FRANSISCO STATE BUILDING AUTHORITY LEASE REVENUE BONDS

- Upgraded from A1 to Aa3. Approximately $50 million was outstanding as of July 1, 2000.

Outlook

The rating outlook for the state is stable. Changes in the approach to budget management has positioned the state to better weather cycles more successfully, despite its volatile revenue structure and inflexible spending base. These include cautious revenue forecasts which avoid committing the most volatile part of the revenue base to fixed expenses, improved reserve levels, and deploying revenue windfalls to one-time investments that improve the state's readiness for future revenue stress. In the near to medium term, the economy is projected to continue to grow, and will continue to outpace the nation. Given the scale of capital needs, the debt burden is likely to grow, further highlighting the importance of new plans to institute a formal multi-year capital planning process.

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